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Introduction

The joint stock cooperative enterprise (JSCE) is a new form of enterprise organization in China. It is not yet fully developed or well understood outside the country, but it is uniquely well suited to Chinese ideological and economic characteristics. The JSCE employs major features of a shareholding system, which originated from western countries in the late 1980s,[1] and has since become a key element in the reform of state-owned enterprises (SOEs).[2]

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1. The shareholding system was not created in China but was borrowed from western countries. The term refers to a situation in which shareholders hold shares of a company, and their liability is limited to the amount of shares subscribed. The original idea of the shareholding system was to attract as much capital investment as possible from society at large. However, in China, the major motivation in adopting the shareholding system was to change the operative mechanism of SOEs, not to invite public investment. *See* HE QINGLIAN, XIANDAIHUA DE XIANJING: DANGDAI ZHONGGUO DE JINGJI SHEHUI WENTI [THE PITFALL OF MODERNIZATION: ECONOMIC AND SOCIAL PROBLEMS OF CURRENT CHINA] 22 (Today's China Press 1998).

2. *See id.* at 19-48. A "state-owned enterprise," formally "state-run enterprise," is defined as a commodity production or operation unit of a socialist character which, in accordance with the law, has autonomy in management, takes full responsibility for its profits and losses, and practices independent business accounting. The property of such an enterprise belongs to the whole people and is operated and managed by the enterprise with the authorization of the state, in accordance with the principle of separating ownership rights and management rights. Such an enterprise enjoys the right to possess, use, and legally dispose of property which the state has authorized it to operate and manage. *See generally* The Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People, 7th Nat'l People's Cong., 1st sess., art. 2.

Enterprises organized on the shareholding principle can be independent from the government and have clearly defined property and ownership rights[3]—basic elements routinely assumed in the corporate law of western countries, but still new in a country constitutionally committed to Marxist-Leninist principles, including ownership of the means of production by the people represented by the state.

The JSCE is particularly well suited for smaller enterprises.[4] Most investors, including foreign investors, are attracted to large SOEs or sometimes large collectively owned enterprises.[5] Organizational forms such as joint stock companies or limited liability companies (which are discussed in detail below) are most suitable for those large enterprises because of their strength in accumulating capital. In comparison, the JSCE emphasizes cooperation among workers and facilitates a direct connection between labor and the means of production.[6] Accordingly, smaller enterprises, whether state-owned or collectively-owned, are best organized as JSCEs because they are more likely to achieve the cooperative spirit essential to this form.[7]

Although the history of JSCEs is fairly short, they have displayed rapid growth. Governments started to use the term "joint stock cooperative" ("*gufen hezuo*") officially in 1985.[8] Five years later, the

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3. *See* HE QINGLIAN, *supra* note 1, at 80-81.

4. According to the *Trial Measures of Second Step of Changing Profits into Taxes for State-Owned Enterprises* issued by the Finance Ministry and approved by the State Council on September 18, 1984, small SOEs are enterprises the fixed assets of which are valued at less than four million yuan (approximately $490,000 (U.S.)), and the annual profits of which are less than 400,000 yuan (approximately $49,000 (U.S.)). This standard should be moved up due to the economic inflation over the fifteen years since that document was issued.

5. The collectively-owned enterprise is generally referred to as a legal person or an economic enterprise in which the means of production are owned by the enterprise, members work jointly, and the distribution is made according to their work. The enterprise has autonomy in management, takes full responsibility for its profits and losses, and practices independent business accounting. *See* GAN PEIZHONG, SCIENCE OF ENTERPRISE LAW AND COMPANY LAW 152 (Beijing University Press 1998).

6. *See* Xiao Liang, *Gufen Hezuo Zhi Shi Gongyouzhi de ZhongYao Shixian Xingshi* [*Joint Stock Cooperative System is One of the Very Important Forms to Realize Public Ownership*], XINMIN EVENING NEWSPAPER (Shanghai), Sept. 21, 1997, at 3.

7. *See id.*

8. *See* Gu Gongyun, *Gufen Hezuo Qiye Lifa de Rougan Yinan Wenti Yanjiu (Shang) [Research on Several Difficult Questions of Legislation for the Joint Stock*

Ministry of Agriculture published the first regulation on joint stock cooperative enterprises.[9] At the ministry level, there are now five documents establishing opinions and regulations for JSCEs.[10] On the local level, more than seventeen documents apply.[11] Almost all the provinces and cities directly controlled by the central government in China have promulgated regulations on JSCE. By the end of 1996, China had more than 4 million JSCEs.[12] This figure increased quickly because the Fifteenth CPC Congress endorsed this form of enterprise.[13]

However, the JSCE form remains highly controversial. The key issue is whether a JSCE is an independent legal entity. Although some commentators assert otherwise,[14] the better position is that a JSCE should be treated as an independent business form.

This article introduces the concept and legal nature of the JSCE and describes its legal characteristics in Part I. It analyzes the concept of a legal person and the distinctions between the JSCE and other business forms, such as joint stock companies, limited liability companies, and partnerships in Part II. Many unresolved issues are addressed in Part III, which focuses on the number of shareholders; transfers of shares; and the establishment, management and distribution of profits and proposes means to improve this new economic form. The Conclusion recommends legislative reforms and evaluates the usefulness of the JSCE to the Chinese economy.

Cooperative Enterprises (Part One)], FAXUE [LEGAL SCIENCE], no. 8, at 49 (1997).

9. *See* Nongmin Gufen Hezuo Qiye Zaixing Guiding [The Provisional Regulations on Joint Stock Cooperative Enterprises Formed by Farmers], Ministry of Agriculture, State Council, Feb. 12, 1990 [hereinafter Provisional Regulations].

10. For detailed information, see GUFEN HEZUO ZHI QIYE GUIFAN YUNZUO ZHIYIN [DIRECTION ON STANDARDIZED OPERATION OF JOINT STOCK COOPERATIVE ENTERPRISES] 140-83 (GU GONGYUN, ED., Shanghai Social Science Academy Press 1998).

11. *See generally id.* at 190-322.

12. *See* GUFENZHI GUFENHEZUOZHI JINGJI FALU ZHENGCE ZIXUN [ADVICE REGARDING ECONOMIC LAWS AND POLICIES ON THE SHAREHOLDING SYSTEM AND THE JOINT STOCK COOPERATIVE SYSTEM] 151 (LI LUNFA, ED., China Central National University Press 1998) [hereinafter ADVICE REGARDING ECONOMIC LAWS AND POLICIES].

13. General Secretary Jiang Zimin has pointed out in his report to the Fifteenth Party Congress that various forms of the joint stock cooperative economic system were new things during the economic reform and should be supported and guided. *See Jiang Zemin Re-Explains the Meaning of Public Ownership System in His Report to the Congress*, MING NEWSPAPER, Sept. 13, 1997, at A8.

14. *See, e.g.*, Shi Qian, *Joint Stock Cooperative System Should Not Be Deemed as an Independent Business Entity*, XING BAO (Hong Kong), Oct. 13, 1998, at 24.

I. Concept and Nature

Due to the short history of the JSCE, it remains in an experimental stage without an established unifying concept. Key issues, addressed in detail below, include different conceptualizations of the JSCE and comparisons to the regular shareholding system and to common law or capitalist forms.

A. *Developing the Key Concepts of the JSCE*

Experimental legislation in China generally starts from the ministry level or the provincial level. After accumulating enough experience, the national legislature will enact a final version of a law.[15] This is the same practice for the JSCE. Six legal documents at the ministry level concern the JSCE.[16] Around 1994, almost all local governments on the provincial level had promulgated rules and regulations on JSCEs. The JSCE system was first created in the countryside and gradually migrated to towns and cities.[17] Because the rules and regulations made by these different institutions are not coordinated, the concept of the JSCE is varied.

In its Provisional Regulations on Joint Stock Cooperative

15. For example, prior to the Company Law of 1993, there were Provisional Regulations of Shanghai Municipality Concerning Joint Stock Limited Companies (promulgated May 18, 1992) and Provisional Regulations of Shenzhen Municipality Concerning Joint Stock Limited Companies (promulgated March 17, 1992). Both regulations are printed in BAKER & MCKENZIE, SELECTED COMPANY REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA 1 (1992).

16. These are (1) Guojia Ti Gai Wei Guyu Fazan Chenshi Gufen Hezuo Zhi Qiye de Zhidao Yijian [The Guiding Opinion of the Committee of State System Reform Regarding the Development of City Joint Stock Cooperative Enterprises] (Aug. 1997); (2) Laodong Jiuye Fuwu Qiye Shixing Gufen Hezuo Zhi Guiding [Rules Regarding Implementing Joint Stock Cooperatives in Service-Type Enterprises] (Ministry of Labour, Comm. of State Econ. Reform, State Tax Bureau & Admin. of State-Owned Assets) (Oct. 7, 1994); (3) Xiang Zheng Qi Ye Chanquan Zhidu Gaige Yijian [Opinion Regarding Reforming Property Rights of Enterprises in the Townships] (Ministry of Agric.) (Mar. 30, 1994); (4) Qinggongye Jiti Qiye Gufen Hezuo Zhi Shixing Banfa [Trial Measures Regarding Joint Stock Cooperatives in Light Industry Collective Enterprises] (Ministry of Light Indus. & Nat'l Coop. For Handicraft Indus.) (1993); (5) Guanyu Tuixing he Wanshan Xiang Zheng Qiye Gufen Hezuo Zhi de Tongzhi [Notice Regarding Implementing and Perfecting Enterprises with Joint Stock Cooperative Systems in the Townships] (Ministry of Agric.) (Dec. 24, 1992); (6) Nongmin Gufen Hezuo Zhi Qiye Zanxing Guiding [Provisional Regulations on Joint Stock Cooperative Enterprises Formed by Farmers] (Ministry of Agric.) (Feb. 12, 1990).

17. *See* ADVICE REGARDING ECONOMIC LAWS AND POLICIES, *supra* note 12, at 152.

Enterprises Formed by Farmers,[18] the Ministry of Agriculture provided the first legal concept of the JSCE. According to this document, the JSCE must include more than three families who voluntarily form a business organization to operate by making contributions in the form of capital, goods, technology and labor. Governmental approval is necessary to establish this kind of business, and the JSCE must accept the state directive plan. The entity must be managed democratically and make distributions mainly in accordance with labor contribution. Some dividends may be allocated in accordance with shareholdings. A pre-condition to distribute dividends is to maintain a public reserve. Finally, it must independently take civil responsibility.

Soon after this document was issued, the same ministry changed several significant terms.[19] In the subsequent document, the JSCE was defined as an "enterprise legal person"[20] or an economic entity in which more than two laborers or investors, through articles of association or agreement, voluntarily form an organization to conduct business. They make contributions in the form of capital, goods, technology and land-use rights. The JSCE should be managed democratically, the distributions should be based on labor and share contribution, and a public reserve should be maintained.[21]

After the JSCE was started in the countryside, it quickly developed in most cities including Beijing, Shanghai, Tianjin, Nanjing, Wuhan, Jinan and Shenzhen. In the process, substantial modifications occurred. For example, some local legislation allows the formation of a joint stock cooperative company (JSCC). Regulations[22] in the Shenzhen Special Economic Zone refer to a

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18. *See generally* Provisional Regulations, *supra* note 9, art. 2.

19. *See* Guanyu Tuixing he Wanshan Xiang Zheng Qiye Gufen Hezuo Zhi de Tongzhi [Notice Regarding Implementing and Perfecting Enterprises with Joint Stock Cooperative Systems in the Townships] (Dec. 24, 1992) [hereinafter Notice of 1992].

20. In China, "enterprise legal person" refers to an enterprise that has funds in conformity with state regulations, has articles of association, has an organizational structure, has premises, and is capable of independently assuming civil liability. It can qualify for the status of a corporation following examination, approval and registration. *See* Zhonghua Renmin Gongheguo Minfa Tongze [The General Principles of Civil Law of the People's Republic of China], 6th Nat'l People's Cong. 4th sess., art. 41 [hereinafter General Principles of Civil Law].

21. *See* Notice of 1992, *supra* note 19.

22. Shenzhen Jingji Tequ Gufen Hezuo Gongsi Tiaoli, 1st Shenzhen People's Cong., 22nd sess., Standing Comm., art. 2 (adopted Apr. 29, 1994) [hereinafter Shenzhen Regulations].

JSCC as an enterprise legal person with registered capital formed by issuing shares with equal value, some of which are subscribed by converting collectively-owned property and some of which are sold. Shareholders of the company enjoy rights and bear duties in accordance with the articles of association. The company is responsible for its debts up to its whole property. For the first time, the JSCE was injected into the corporate concept.[23] Significantly, the joint stock cooperative system is becoming recognized by governmental authorities throughout China. However, this system can contain different forms.[24]

None of the official documents provides a fully satisfactory definition of the JSCE, a flaw that is unfortunate but understandable given that this business form has so short a history in China and that no clear analogues exist elsewhere. Nevertheless, it is possible, based on the current official documents, to define the JSCE as an enterprise formed by a certain number of farmers or workers, with registered capital, formed mainly by share contributions. Shareholders adopt articles of association of the enterprise based on the principles of joint stock and cooperation. They jointly enjoy the rights and bear the duties. The enterprise is a legal person that pursues profits and common interests.[25]

A JSCE, defined in this manner, bears much in common with regular joint stock companies. It is important, therefore, to further examine the ownership and internal structure of the JSCE.

B. The Nature of the JSCE

The JSCE is a legal person that is similar to other enterprises with legal person status, meaning that it is an organization that has civil capacity and is competent to perform civil acts. In accordance with the relevant law, it can independently enjoy civil rights and assume civil duties.[26] The purpose and status of the entity are as follows:

(1) Profit Motivation

In China, legal persons are divided into enterprise legal persons

23. For the purpose of this paper, the term JSCE will be used throughout.

24. In China, the terms "enterprise" and "company" are used interchangeably even though differences exist.

25. *See* Gu Gongyun, *supra* note 8, at 50.

26. *See* General Principles of Civil Law, *supra* note 20, art. 36.

and institutional legal persons.[27] Enterprise legal persons mainly engage in economic activities for the purpose of profits. In contrast, institutional legal persons (such as China's Women's Federation) usually are not oriented toward profits, and so are usually not in company form. By its nature, the JSCE is certainly in the category of enterprise legal persons.

(2) Common Interests of Members

Because a JSCE is owned by and emphasizes cooperation among its workers, it naturally will seek to promote the common interests of its members, which is consistent with promoting the economic interests of the whole enterprise. For this reason, a JSCE provides statutory common reserve funds. The funds are usually intended to make up the losses of the business and to increase the capital of the enterprises.[28]

(3) Legal Status

A JSCE must satisfy the requirements of a legal person under the civil law. It must be established in accordance with law; possess the necessary property or funds; possess its own name, organizational structure, and premises for operation; and be able to independently assume civil obligations.[29]

C. Contrast to Common Law/Capitalist Business Structures

The JSCE form of enterprise is usually not seen in western countries, although in the United States there are several consumer and agricultural cooperatives.[30] In England, a cooperative is a business enterprise in which membership and participation in profit are linked to the provision of labor, produce, or the use of facilities, rather than to the contribution of capital.[31]

In theory, the form of a JSCE should be superior to other

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27. *See id.* art. 41-50.

28. *See* Shenzhen Regulations, *supra* note 22, art. 68.

29. *See id.* art. 37.

30. Consumer and agricultural cooperatives are familiar to many Americans, especially in rural areas. In these organizations, people join together as buyers or sellers creating a group that will have greater power in the marketplace than any of its individual members. If profits result from the enterprise and are distributed to the members on an equitable basis. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 1144 (4th ed. 1992).

31. *See* TOM HADDEN, COMPANY LAW AND CAPITALISM 414 (2d ed. 1977).

business forms such as a joint stock company or a limited liability company for small enterprises. The following three points support this conclusion:

(1) A Balance of Capital and Labor Interests

The strongest feature of stockholding companies is their ability to gather capital from workers and sometimes the public. For a JSCE, however, the ability to accumulate capital from the public is restricted by the strong preference for ownership by workers. Because Chinese workers generally have very little money available for investment, the capitalization of JSCEs is likely to be relatively small. But the compensatory advantage is the level of cooperation that results from avoiding conflicts between the suppliers of labor and the suppliers of capital.

(2) Democratic Management

A perfect combination of cooperation and ownership allows management in a democratic manner. On most issues, the JSCE operates on the same "one person, one vote" principle that is used in partnerships. However, on the more important issues such as merger or dissolution, the JSCE uses the "one share, one vote" principle, recognizing the greater interests of certain owners.[32]

(3) Equitable Distribution of Revenues

Revenues of the enterprise are distributed partly as wages, based on labor contribution, and partly as dividends, based on capital

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32. *See* Interim Measures on Joint Stock Cooperative Enterprises, Shanghai Municipality, May 17, 1997, arts. 28, 30. Article 28 provides that the shareholders can exercise powers and functions: (1) to determine the company's business policy and investment plans; (2) to elect and replace legal representatives or directors and determine their remuneration; (3) to elect and replace supervisors who are the representatives of shareholders and to determine the remuneration of supervisors; (4) to discuss and approve the reports compiled by the board of directors or legal representative; (5) to discuss and approve the reports compiled by the supervisory committee; (6) to discuss and approve the company's annual budget plans and final accounting plans; (7) to discuss and approve the company's profit distribution plans and loss recovery plans; (8) to pass resolutions on matters such as the increase or reduction of the company's registered capital and company merger, division, restructure, dissolution or liquidation; (9) to amend the company's articles of association; (10) to decide other important issues provided by the company's articles of association. Article 30 provides that the vote-by-shares method should be used for Article 28(1), (2), (8) and (9) while the vote-by-person method should be used for Article 28(3)-(7) and (10).

contribution. For this reason, it is recommended that each farmer or worker own equal amounts of shares.[33] The simple reason is that if some farmers or workers own a disproportionate number of shares, they will receive a disproportionate share of the profits, which would create the danger of exploitation and dilution of the meaning of labor cooperation.

D. *Marxist Influence*

The relationship of any entity to Marxist ideology is critical in a socialist country. It is therefore important that the JSCE be consistent with the theory of Karl Marx expressed in *Das Kapital*, combining a number of his key ideas into one organizational form. Marx recognized that the key advantage of a joint stock company is its ability to accumulate and attract investment in productive enterprises. This form was so promising, he believed, that the joint stock company was the best form to lead to communism. Moreover, Marx strongly recommended cooperation among workers and preferred an enterprise to be formed by workers themselves rather than a simple joint stock company.[34]

II. The JSCE as Distinguished from Other Business Forms

The special appeal of the JSCE is best understood in comparison with alternative forms of business organization, specifically the joint stock company, the limited liability company, the partnership enterprise, and the commune. The key comparative aspects are the scope of investors, the relationship among investors, the distribution of profits, and internal structure.

A. *The Joint Stock Company (JSC)*

According to the Company Law of 1993,[35] a joint stock company has capital composed of shares of equivalent value and is responsible

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33. *See* Xiao Liang, *supra* note 6.

34. *See* Hu Yicheng, *Yong Shengchanli Biaozhun Kan Gufen Zhi he Gufen Hezuo Zhi* [*Examination of the Joint Stock System and the Joint Stock Cooperative System by Using the Standard of Productive Forces*], FAZHI BOLAN [EXTENSIVE STUDY OF LEGAL SYSTEMS] No. 1, at 9 (1998).

35. *See* Zhonghua Renmin Gongheguo Gosifa [Company Law of the People's Republic of China] 8th Nat'l People's Cong., 5th sess., Standing Comm. (adopted Dec. 29, 1993, effective July 1, 1994) [hereinafter Company Law of 1993].

up to its total assets for company debt.[36] As most Chinese people believe, both the JSCE and the JSC are forms of public ownership.[37]

However, there are important differences between the two forms:

(1) The JSCE is oriented not only to increase its capital but also to promote cooperation among its workers. This is why the majority of ownership is limited to farmers or workers. In contrast, the JSC focuses on capital and is controlled by the majority shareholders. Although workers may acquire a certain number of shares,[38] the norm is that most shares are held by investors who are not employees of the enterprise.[39]

(2) The JSCE distributes its income mainly based on the work performed. Shareholders, who are predominantly the workers, may also receive dividends, but only if sufficient income is available. By contrast, investors in the JSC usually receive dividends only.

(3) The JSCE avoids the employer/employee relationship. Because most investors have mutual ownership, they together occupy, use, and manage the means of production and together distribute the profits. Therefore, at least in theory, there is no exploitation of the workers' labor. In the JSC, by contrast, the owners and employees are separate. The employees receive salaries or other benefits through their labor while the owners receive the profits.

(4) Investors in the JSCE usually have limited freedom to

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36. *See id.* art. 3(3).

37. Some people believe that shareholding systems will lead to privatization. But Mr. Xu Guangchun, spokesman for the Fifteenth Party Congress, has pointed out that turning state-owned enterprises into shareholding companies does not mean that China promotes privatization. As he has stated, "[R]eforms of state-owned enterprises will lead to a strengthening of the State sector. The State will always be the biggest shareholder of these companies." Daniel Kwan, *Enterprise Reform Not Privatization*, S. CHINA MORNING POST (Hong Kong), Sept. 12, 1997, at 12. But at least one commentator believes that such a shareholding system is actually a "social ownership system." DING XUELIANG, GONGCHANZHUYI HOU YU ZHONGGUO [POST-COMMUNISM AND CHINA] 45 (1994).

38. In China, several classes of stock are established on the basis of characteristics of the investors for which the shares are intended: state shares, legal person shares, individual shares (including internal employee shares and public individual shares) and foreign capital shares. *See* Minkang Gu & Robert C. Art, *Securitization of State Ownership: Chinese Securities Law*, 18 MICH. J. INT'L L. 115, 128-130 (1996).

39. Because of this philosophy, some powers, such as the right to issue bonds, are given to shareholders. *See* Wan Kejia, *Gufen Zhi yu Gufen Hezuo Zhi de Jieding* [*The Line Between the Shareholding System and the Joint Stock Cooperative System*], FAZHI DAILY (Beijing), Dec. 20, 1997, at 7.

transfer their shares to outsiders. But in the JSC, due to the nature of public companies, the transfer of shares is easy and unrestricted.

(5) In the JSCE, the board of directors is responsible to the workers, who are also the shareholders. Therefore, the workers are the highest authority of the enterprise. By contrast, in the JSC, the board of directors generally is in charge of the company, despite the Company Law of 1993 providing that the board of directors shall be responsible to the shareholders.[40]

(6) The JSCE is intended for small enterprises, while the JSC is usually for larger enterprises. The JSC, unlike the JSCE, offers shares to the general public.[41]

B. The Limited Liability Company (LLC)

The JSCE has a number of characteristics in common with the limited liability company.[42] Both are enterprise legal persons, in which shareholders are only liable up to their contribution. In both the JSCE and the LLC, there is an emphasis on personal relationships among investors and there are limitations on the transfer of shares.

However, the following differences exist between the JSCE and the LLC:

(1) Different numbers of members: An LLC can only have from two to fifty shareholders,[43] while a JSCE can have over fifty shareholders.

(2) Different qualifications: The shareholders of a JSCE are required to be workers of that enterprise. There is no such requirement for shareholders of an LLC.

(3) Different registered capital: A prerequisite to forming an LLC is a minimum investment by the shareholders.[44] For a JSCE, future legislation is expected to provide minimum registered capital.

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40. *See* Company Law of 1993, *supra* note 35, art. 112.

41. *See* Guiguo Wang & Roman Tomasic, *China's Company Law, in* BUTTERWORTH'S 73 (1994).

42. LLCs are governed by the Company Law of 1993. *See generally* Company Law of 1993, *supra* note 35.

43. *See id.* art. 20.

44. *See id.* art. 19. *See also id.* art. 23 (providing that the minimum registered capital of an LLC shall be: (1) RMB 500,000 for a company the main business of which is production; (2) RMB 500,000 for a company the main business of which is wholesale; (3) RMB 300,000 for a company the main business of which is retail; and (4) RMB 100,000 for company the main business of which is the development of science and technology, consultation, or the provision of services.

Although it is not clear at present what that minimum will be, the registered capital will obviously be different due to the different natures of the forms.

(4) Different voting rights and procedures: In an LLC, the law provides that the shareholders vote at the shareholders' meeting in accordance with the proportion of the capital contributed.[45] In a JSCE, voting is a combination of "one person, one vote" and "one share, one vote."

C. The Partnership Enterprise (PE)

A partnership enterprise is a profit-seeking organization established within Chinese territory in accordance with the provisions of the Partnership Enterprise Law.[46] All the partners must sign a partnership agreement and agree to jointly contribute capital, jointly manage business operations, jointly share profits and bear risks, and jointly assume unlimited joint and several liability for partnership debts.[47] The JSCE is similar to the PE in that both are formed for profit, all members contribute capital, and both the enterprise and the shareholders must pay income tax.[48]

However, many differences exist:

(1) Different legal status: The JSCE is legally recognized as an enterprise legal person so it can have a legal representative, while the PE has no such legal status.

(2) Different liability: In a PE, all partners bear unlimited liability; i.e., they are jointly and severally liable for all the debts incurred by the enterprise.[49] In a JSCE, a shareholder's liability is limited to the amount of shares that he or she holds.

(3) Different employment relationships: In a PE, partners may work, but frequently hire employees to work for them. In a JSCE, the expectation is that most shareholders will work for the enterprise.

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45. *See id.* art. 41.

46. *See* Zhonghua Renmin Gongheguo Hehuo Qiye Fa [The Partnership Enterprise Law of the People's Republic of China], 8th Nat'l People's Cong. 24th Sess., Standing Comm., Feb. 23, 1997 [hereinafter Partnership Enterprise Law].

47. *See id.* art 2.

48. Interestingly, the partnership enterprise itself has to pay income tax which is usually not levied in western countries, where unlimited liability is accepted as the price for the avoidance of double taxation. *See id.* art. 37; *see also* N. C. Howson, *Flood Legislation Clears the Way of New Corporation Form, But Are They Worth It?* CHINA JOINT VENTURE, July/Aug. 1998, at 11.

49. *See* Partnership Enterprise Law, *supra* note 46, art. 8(1).

(4) Different management: In a PE, the business is usually run by partners or their agents. Also, there is an employment relationship between partners and employees. However, in a JSCE, shareholder-workers closely control the enterprise and the intention is to eliminate the distinction between owners and employees.[50]

(5) Different manner of distribution: In a PE, partners share profits in the proportions stipulated in the partnership agreement.[51] In a JSCE, the distribution is based on each members work and shares.

D. The Commune

Both the JSCE and the commune emphasize cooperation among workers. In China, communes were created in the 1950s and were heavily influenced by government administration. In the so-called people's commune, all the members contributed their capital and tools but eventually lost control. Nevertheless, the spirit of cooperation was maintained. Today, the formation of a JSCE combines aspects of a commune and a corporation.

There are several differences between the JSCE and the commune:

(1) Different motivation: The JSCE focuses not only on cooperation among workers, but also on profits. Therefore, the JSCE welcomes market economics while the commune rejects the basic principle of market economics.[52] Current Chinese communes have a problem of clearly identifying property rights. This may be the major reason to abolish people's communes in China.[53]

(2) Different distribution: In the JSCE, distribution is based on work and shareholding. In the commune, by contrast, all payments or distributions to individuals are made on the basis of need rather than merit, work performed, or goods supplied.[54]

(3) Different management: In the JSCE, the enterprise is usually managed by workers and shareholders in a cooperative manner. It could also absorb investments from outside in order to expand its business. To the contrary, the commune mainly emphasizes the

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50. *See* Xiao Liang, *supra* note 6.

51. *See* Partnership Enterprise Law, *supra* note 46, art. 32.

52. *See* HADDEN, *supra* note 31, at 415.

53. *See* The Bulletin, 15th CPC Cong., 3rd sess, *available at* <http://www.peopledaily.com.cn/item/xhs/981014/Ap8/html>.

54. *See* HADDEN, *supra* note 31, at 415.

interests of members but not the interests of property contributors.

III. Unresolved Issues

The JSCE is a new enterprise system that is independent and has better organization than other business forms. It has many advantages over other business forms and avoids their disadvantages.[55] Because of its early state of development, many unresolved issues exist.

A. *Specified Number of Shareholders*

An existing state-owned or collectively-owned enterprise may be converted into a JSCE with contributions from the original farmers, workers, or staff. In the case of a newly formed enterprise, however, the number of original participants or investors becomes critical. To form a JSCE, some regulations require at least two laborers or investors;[56] some require at least three promoters and more than twenty shareholders;[57] some require that at least eight shareholders be workers;[58] and some are silent on the number of investors and members.[59] Also, most regulations allow investors to be either natural persons or legal persons, but, again, there is no consistency. One local regulation[60] provides that investors could be natural persons, legal persons, individual industrial and commercial households, rural contracting households, other economic organizations and social organizations, or the people's government at the township level. Those provisions seem similar to those of the Company Law.[61] Both

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55. *See* ADVICE REGARDING ECONOMIC LAWS AND POLICIES, *supra* note 12, at 150-51.

56. *See, e.g.*, Notice of 1992, *supra* note 19 (requiring more than two laborers and investors).

57. *See, e.g.*, Liaodong Jiuye Fuwu Qiye Shixin Gufen Hezuo Zhi Guiding [Regulations Regarding Implementation of the Joint Stock Cooperation System in Service Type Enterprises] (Ministry of Labour, State Comm. of System Reform, State Taxation Admin. & State Admin. of State-Owned Assets) art. 14 (Oct. 7, 1994).

58. *See, e.g.*, Shanghai Gufen Hezuo Zhi Qiye Zaixin Banfa [Shanghai Provisional Measures Concerning Joint Stock Cooperative Enterprises] art. 9 (May 17, 1997) [hereinafter Shanghai Regulations].

59. *See, e.g.*, Shenzhen Regulations, *supra* note 22.

60. Regulations of Guizhou Province on Joint Stock Cooperative Enterprises, 8th People's Cong. of Guizhou Province, 12th sess., Standing Comm., art. 6 (Nov. 29 1994).

61. Company Law of 1993, *supra* note 35, art. 75. Article 75 provides that the establishment of a company limited by shares shall be by five or more promoters, and that a one-half majority of the promoters must have their domicile within the

in theory and in practice, these conflicting requirements will affect the nature of the JSCE. As mentioned before, the JSCE should be promoted or established mainly by worker-owners. If legal persons are allowed to be promoters, then the result will be that the legal persons and workers will hold disproportionate shares.

At present, it is not certain whether the JSCE is also governed by the Company Law of 1993 or is instead a business form under separate statutes such as the Chinese Partnership Enterprise Law of 1997. According to Chinese legal practice, the Company Law of 1993 is usually treated as a general law for all other relevant company regulations. Those other regulations are treated as special regulations and given priority of application,[62] but the general law controls issues where the special regulations are silent. Therefore, it is safe to say that current JSCEs are generally governed by the various regulations,[63] but that the national Company Law may offer some guidelines.

B. Special Requirements for Stock Ownership

To the extent practicable, each participant in a JSCE should have dual status as a worker and an owner of the enterprise. The distinctive role of the JSCE is to combine these two functions and to eliminate the conflicting interests between capital and labor. If a JSCE does not limit share ownership to its workers, the result will be too similar to a regular joint stock company or limited liability company.

In some situations, if the enterprise has financial difficulties, then outsiders, possibly including foreign investors, can be involved. Still, the major investors should be inside workers.[64] If a JSCE wants to open a door for external investors, it must be aware of two limitations: domestic legal persons cannot hold more than 39% of the

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territory of China. *Id.* If a state-owned enterprise transforms into a company limited by shares, there may be less than five promoters, but the share float method shall be adopted for its establishment. *See id.*

62. *See* Company Law of 1993, *supra* note 35, art. 18. Article 18 provides that the Company Law shall apply to limited liability companies with foreign investment. *Id.* Where laws concerning Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and foreign-funded enterprises provide otherwise, such provisions shall prevail. *See id.*

63. *See, e.g.*, Wuhan Shi Guoyou Xiao Qiye Shixin Gufen Hezuo Zhi Gaizu Banfa [Measures of Transferring Small Size State-Owned Enterprises into the Form of Joint Stock Cooperative System] (Gov't of Wuhan City) (June 1, 1995).

64. *See* Shanghai Regulations, *supra* note 58.

shares and no more than 25% of the shares can be available to foreign investors.[65]

The 25% limit on foreign-owned shares conflicts with laws and regulations concerning foreign-funded enterprises, which provide that foreign investors must invest capital or subscribe shares which constitute more than 25% of the registered capital.[66] If foreign investment in a JSCE is allowed to exceed 25%, then the JSCE will be foreign-funded, which is never permitted by the Chinese government. Holders of 25% typically have a large voice inside the enterprise. Foreign investors who wish to acquire substantial or majority control of an enterprise should choose a different investment vehicle.

C. Transfer of Ownership

Many regulations provide that shares can be transferred without limitation. This contradicts the nature of the JSCE. Although this point is sometimes misunderstood, restrictions are necessary. If JSCE members had no ability to transfer or trade their shares, it would be very difficult to reorganize the capital or to rearrange the source of capital.[67] However, if owner-workers are allowed to freely transfer their shares, like shareholders of joint stock companies, then they might lose their standing as shareholders while retaining their employment. In that situation, the true meaning of joint stock cooperation would be affected.[68] These competing considerations can be accommodated by allowing transfer of shares subject to certain limitations. For example, a holder seeking to transfer shares should be required to offer them first to existing shareholders, workers, or the enterprise, through a right of first refusal.[69] The articles of

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65. *See id.*

66. *See, e.g.*, Guanyu Sheli Waishang Touzi Gufen Youxian Gongsi Ruogan Wenti de Zaixin [Provisional Regulations on Several Issues Concerning the Establishment of Foreign Investment Companies Limited by Shares] (Ministry of Foreign Trade and Econ. Cooperation) art. 2 (Jan. 10, 1995).

67. *See id.*

68. Certainly the questions can go on and on. In which situations could a worker-owner transfer his shares? If he could not sell his shares to an outsider, could he sell to his family members or leave them to heirs? If he could sell his shares to outsiders, could purchasers of the shares gain rights to employment? When a worker retires, must he sell his shares back to the company?

69. *See*, Shanghai Regulations, *supra* note 58. Article 26 provides that if a shareholder wants to transfer his shares, the other shareholders will have the right of first refusal. However, the percentage of shares transferred is subject to further

association or relevant statutes must reflect those limitations in the future.

D. *Procedures for Legally Establishing a JSCE*

Although the formation of a JSCE is regulated by multiple regulations, the regulations are scattered and far from effective or complete. At present, no national regulations specify the conditions and procedures for forming a JSCE. Because current JSCEs are registered with similar authorities, such as the Administrations for Industry and Commerce, it is advisable to follow the general procedures of the Administrative Rules of the People's Republic of China governing the Registration of Companies.[70]

Specifically, a state-owned enterprise that decides to convert into a JSCE should follow these procedures: (1) a resolution must be approved by the enterprise's representative assembly of staff and workers, the capital contributors, and the relevant government body; (2) the state-owned assets must be appraised; (3) the articles of association must be discussed and adopted; (4) the different classes of shares must be clearly specified; and (5) the enterprise must seek approval and registration.[71]

E. *Minimum Registered Capital*

Thus far, most enterprise regulations in China require that a minimum of registered capital must be contributed for the purpose of protecting creditors. In establishing this minimum, however, legislators must bear in mind the distinctive characteristic of concurrent ownership and employment within a JSCE. The preponderance of shares should be held by workers and staff.

Most JSCEs are transferred from existing collective-owned enterprises or small state-owned enterprises. In these instances, the existing assets are accepted in exchange for shares, easily satisfying the minimum requirements.[72]

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limitations under Article 9 (at least 8 worker shareholders), Article 21(shares held by workers should be more than 51% of total shares), Article 22 (the legal person shares should not exceed 39% of total shares) and Article 23.

70. *See generally* Zhonghua Renmin Gongheguo Gongsi Dengji Tiaoli, State Council of China (June 24, 1994).

71. *See generally* Siu Hongche, *Gufen Hezuo Zhi Qiye Gaizhao de Moyi Fangan [Simulated Plan for the Establishment of a Joint Stock Cooperative Enterprise]*, 2 CHINESE LAW. 14 (1998).

72. However, it must be noted that some local governments decide the selling

New JSCEs, by contrast, are formed by contributions from the workers, so the amount of capital may not be enough to satisfy the minimum requirement. Furthermore, the law does not specify whether the minimum capital is the same for a newly formed JSCE or for a JSCE that has been converted from an SOE. Laws or regulations should establish the minimum capital at the lowest possible level to permit workers to organize this form of enterprise. Thus far, one local regulation[73] provides that the registered capital should be no less than 2 million yuan. One official document[74] has proposed a requirement below 10 million yuan.

F. Property Rights

The concept of property rights is far from unified in China. Some people support the idea that property rights consist of the rights to occupy, use, benefit, and dispose of property.[75] To others, property rights consist of ownership in a broad sense. To conclusively resolve these uncertainties, a detailed system of ownership should be provided by laws, regulations or agreements.[76]

The best definition of property rights would be ownership rights (the traditional four rights of possession, use, profit, and disposition), plus other rights that are naturally related to those, such as the right to hold someone liable as a result of owing money to the owner.[77] Furthermore, property rights can be in a tangible or intangible form.[78]

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price of the small size SOEs without any rationale. They can simply fix the selling price based on the price the workers can afford. *See generally* Lian Hua, *Guyou Qiye Chanquan Jiaoye de Falu Shiyong* [*The Application of Law During the Trade of Property Rights of State-Owned Enterprises*], 2 CHINESE LAW. 9 (1998).

73. Shenzhen Regulations, *supra* note 22, art. 16.

74. Comm. of System Reform, Shanghai Guanyu Jinyibu Fazan Gufen Hezuo Zhi Qiye de Rougan Yijian [Further Development of Joint Stock Cooperative Enterprises in Shanghai] No. 162, Item 5 (1994).

75. Actually, this is the dominant position in China. *See* General Principles of Civil Law, *supra* note 20, art. 71; *see generally* Zhang Naigen, *Guojioa Gu Shangshi de Fa Jingjif Tanxi* [*Research on the Law of Listing State Shares from the Angle of Economic Law*], 2 CONTEMP. LEGAL RES. 39 (1993).

76. *See generally* Wu Xuangong, *Lun Faren Caichanquan* [*The Property Rights of the Legal Person*], 2 CHINESE SOC. SCI. 26 (1995).

77. *See generally* Kang Chenji et al., *Qiye Guoyou Chanquan Zhuanlang Difang Lifa de Tanshuo yu Shijian* [*Research and Practice of Local Legislation of Transfer of Property Rights of State-Owned Enterprises*], 1 HEBEI LEGAL SCI. 20 (1997).

78. *See* JINGJIFA JIANMING JIAOCHEN [BRIEF INTRODUCTION TO ECONOMIC LAWS] 149 (Chen Jiaqiu & Fan Peng eds., East China University of Science and Engineering Press 1996).

From this perspective, the JSCE is also unclear about property rights, particularly in regard to the relationship between individual ownership and collective ownership.

(1) Conversion from Collectively Owned Enterprises

When an existing collective enterprise is converted into a JSCE, how are property rights determined? According to the Notice of 1992, the shares of the JSCE should be divided into state shares, legal person shares, social individual shares, and internal shares for workers and staff (including individually owned shares and collectively owned shares).[79]

In practice, it may not be difficult to label those shares, but it may be very difficult to figure out those shares, especially the difference between state assets and collectively owned assets. As one author points out, most collectively owned enterprises include state-owned assets and other assets with no clear ownership, such as the assets formed because of a reduction of or an exemption from taxes and assets formed through special government policies.[80]

Furthermore, as mentioned above, the internal shares for workers could be further divided into individually owned shares (paid by subscription) and collectively owned shares (the original form of accumulated funds). In theory, the collectively owned shares should be owned by all workers inside the enterprise. The question now is whether the collectively owned shares should be further divided into equal amounts and given to workers individually. If so, will this constitute privatization? The answer should be no, if the future JSCE law copies the basic idea of the existing Company Law.[81]

However, most regulations clearly intend to exclude state shares in order to promote the autonomy of the JSCE. Thus, all state-owned assets must be sold to workers of the enterprises. If this is the case, then it is important to have a correct valuation of state-owned assets based on market price in order to prevent the loss of state-owned assets.[82]

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79. *See generally* Gu Gongyun, *Gufen Hezuo Qiye Lifa de Rougan Wenti Yanjiu (Xia)* [*Several Hard Questions Regarding the Legislation of Joint Stock Cooperative Enterprises (Part Two)*], 9 LEGAL SCI. 40 (1997).

80. *See generally id.*

81. *See* Company Law of 1993, *supra* note 35, art. 117 (providing that a company shall allocate 10% of its annual after-tax profit to its statutory accumulation fund and 5-10% to its statutory public welfare fund).

82. It was estimated that state-owned assets worth $10 billion (U.S.) have been

(2) Outside Investment

Should a JSCE attract capital investment from outside the enterprise? One view is that investment from outsiders must be excluded to preserve the essential nature of the JSCE. Another view is that capital from outsiders is allowed, consistent with all JSCE regulations. Actually, investment from outsiders is very practical, since most enterprises need funds. But the percentage of the shareholding by outsiders must be limited.

(3) Issuance of Shares Without Cash Payment

A JSCE typically issues shares to individual workers by subscription. In some situations, however, shares have been distributed to workers without any payment from them. Furthermore, it is unclear whether goodwill or credit are acceptable forms of contribution.

G. Management

Since the JSCE is a new form of business in China, its internal management structure and its independence need to be improved. The current regulations hold different views of internal management structure. Some regulations[83] provide that the shareholders' general meeting should be the highest authority of the JSCE. The meeting elects directors to form the board of directors (BOD). The BOD appoints a manager or factory director to be in charge of business operations.

Taking a different approach, other regulations[84] provide that the highest authority of the JSCE should be the special meeting combining the shareholders' meeting and the assembly of workers representative of the enterprise. This special meeting is responsible for electing the BOD. The BOD then appoints a manager or factory director. Because of the nature of the JSCE, it is reasonable to expect that the highest authority of the JSCE would be a special meeting combining shareholders and workers.

Furthermore, almost all JSCE regulations require a supervisory

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lost per year due to various reasons including the implementation of the shareholding system. *See State-Owned Funds Suffer Loss: 10 Billion U.S. Dollars Per Year*, MINGPAO NEWSPAPER (Hong Kong), June 23, 1997, at A15.

83. *See, e.g.*, Shenzhen, Wuhai, Jinan, Xian [Regulations of the JSCE in Shanghai].

84. *See, e.g.*, Nanjing, Haerbing [Regulations of the JSCE in Beijing].

board that oversees the management of the BOD and its agents. One local rule, however, provides that the supervisory board be formed by representatives of the Communist Party and the head of the representative assembly of workers.[85] Obviously, under this formula, shareholders are missing from the supervisory board.

Most JSCEs will have collective shares, legal person shares, and worker shares. Because collective shares are usually owned by village or township governments, the local governments may have a large voice and can easily interfere with the business of the enterprise. Further legislation should prevent this situation.

H. Distribution of Income

Three problems exist regarding the distribution of income. First, most JSCEs pay dividends to shareholders before paying taxes, and pay bonuses after taxes. Moreover, the payment of dividends is guaranteed.[86] This approach is intended to induce more and more workers to invest their money. Also, the dividends are calculated into total costs.

Actually, though, these policies and calculations are incorrect, reflecting a misunderstanding of key concepts of modern business practice and the nature of stockholding enterprises. Dividends are distributions of profits, not costs, and should only be paid if there is a surplus. The guarantee of dividends benefits workers, but at the expense of the collective and state interests. The decision to issue dividends should be at the discretion of the enterprise's governing body and vary from year to year based on the profitability in a given year and the future capital needs of the enterprise.

Second, all JSCEs are required to keep a common reserve fund (usually 20-30% of the profits after taxes). Usually this fund cannot be divided among individuals. The fund is deemed the symbol of the socialist collective nature of the enterprise. However, a question remains if a JSCE is dissolved: Will the workers or shareholders be entitled to receive this money proportionally?

That interpretation of the common reserve fund, however,

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85. *See Measures of Transferring Small Size State-Owned Enterprises into Joint Stock Cooperative Systems in Wuhai City*, Fagui Huibian, art. 24 (1995).

86. *See* GONGSI DE SHELI YU YUNZUO: GONGSI FA YU QIYE GAIZHI SHIWU [ESTABLISHMENT AND OPERATION OF COMPANY: PRACTICAL MANUAL OF COMPANY LAW AND REFORM OF ENTERPRISE] 245 (Gu Gongyun ed., Fudan University Press 1996).

conflicts with the shareholding system, which identifies property rights. The interpretation may make the JSCE similar to the traditional collective enterprises in which individuals cannot claim any personal property rights, thereby negating the advantages of the JSCE form.

Third, the relationship between distribution based on work and distribution based on shares should be further harmonized. It is obvious that as an investor, a JSCE member will seek high profits, but as a worker, he will promote high salaries and benefits. If the relationship cannot be harmonized, members will not have an incentive to invest or work in such an enterprise.

Conclusion

In theory, the JSCE combines the advantageous characteristics and values of the shareholding system with those of the cooperative system through concurrent ownership and employment. The JSCE can enlarge the size of the enterprise, effectively organize substantial investment and many people to achieve greater productivity, and do so based on the principle of worker cooperation.[87] By melding the roles and contributions of capitalists with those of workers, the JSCE can eliminate typical conflicts.

For these reasons, the JSCE has strong support politically, ideologically, and constitutionally. Chinese leaders strongly recommend the JSCE as an important business form in socialist society.[88] Others, including the pioneer of the shareholding system, Tong Dalin, contend that the shareholding system is a socialist ownership form.[89] Still others describe the JSCE as a new form of Chinese collective economy.[90] Furthermore, the Chinese Constitution contains a provision to support this new business form.[91] The JSCE

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87. *See id.* at 8-9.

88. During the Fifteenth Party's Congress, Jiang Zemin, Li Peng and Chu Rongji addressed this system. *See* XINMIN EVENING NEWSPAPER (Shanghai), Sept. 21, 1997, at 17.

89. Professor Tong Dalin initiated the shareholding system in the 1980s. *See* Tong Dalin, *Danxin Gufen Zhi Bei Niuqu* [*Worry of Misunderstanding of the Shareholding System*], MINGPAO NEWSPAPER (Hong Kong), Sept. 23, 1997.

90. *See, e.g.*, *The Newspapers in Beijing Propagate the System of Joint Stock Cooperatives*, MINGPAO NEWSPAPER (Hong Kong), Aug. 8, 1997, at 12.

91. *See* Zhonghua Renmin Gongheguo Xianfa [Const. of P.R.C.], 5th Nat'l People's Cong., 5th sess., art. 8 (amended Mar. 29, 1993). Article 8 provides that in rural areas, the responsibility system, the main form of which is a household contract that links remuneration to output, and *other forms of cooperative economy*, such as

experiment has been tried in China for more than ten years, providing strong evidence of the necessity and possibilities of this new form.

However, in both theory and practice, the nature of the JSCE is still uncertain. Many people believe that the JSCE is a private enterprise because the capital is owned by each member individually.[92] Another view holds that the JSCE is not an independent enterprise form. According to this view, it is impossible to have harmony between profit-seeking and labor cooperation. Furthermore, most registries in China still write "collective enterprise" or "shareholding company" when they issue licenses to JSCEs.[93]

Even with the existing problems as discussed, the JSCE is a promising and advantageous form of enterprise organization that should be encouraged, developed and expanded. Its unique contribution is to reconcile and unify the interests of capital and labor within a single enterprise, promoting cooperation, efficiency and productivity, for the benefit of not only that enterprise and its worker-owners, but also society as a whole. It modifies a capitalist form of enterprise organization in a manner that harmonizes it with Marxist ideals.

To achieve its potential, the JSCE should be further defined by new legislation that is clearer, more complete, and somewhat modified. Internal management structures should be further perfected and property ownership issues should be resolved. The relationship between enterprise shares and individual shares should be further harmonized. Distribution rules and processes should be made more consistent with the essential nature of the JSCE form. Outsiders should be permitted to invest a certain amount of capital; their shares should be classified as preferred shares with a specified return on investment, but should not include management rights in order to preserve the principle that JSCEs are owned and operated by worker-shareholders.

With changes and clarifications such as these, the JSCE form can contribute significantly to the Chinese economy. Many small state-

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producers', supply and marketing, credit, and consumers' cooperatives, belong to the sector of socialist economy under collective ownership by the working people. *Id.*

92. *See, e.g.*, Liu Dazheng, *Gufen Zhi Gaige: Zhibing Haishi Doming* [*Reform Through the Shareholding System: Cure the Disease or Take Away the Life?*] MINGPAO NEWSPAPER (Hong Kong), Oct. 13, 1997, at 24.

93. *See* Shi Qian, *supra* note 14.

owned enterprises and collectively owned enterprises could adopt this form to realize a new form of public ownership structured to promote efficiency, productivity, and a cooperative spirit among workers and owners.